



# IMPACT OF VAT ON INDUSTRIAL SECTOR

## INTRODUCTION

The member countries of the Gulf Cooperation Council (GCC) have signed a Unified Agreement on VAT containing the majority of the regulation for the operation of VAT. Each of the 6 countries under the GCC will complete the rules with their own VAT laws. As Kuwait is yet to issue its own VAT law, the content in this newsletter is based on guidelines given under the Unified Agreement or common practices followed by other countries.

## VAT IN SIMPLE TERMS

- VAT is a consumption-based tax levied on every value addition made at each stage of the product cycle.
- The standard rate of VAT as per the Unified Agreement is 5%.
- Apart from the standard-rated goods there are a few exceptions for zero-rated and exempted goods. Each country will issue the list of such zero-rated and exempted supplies in its VAT legislation.
- Businesses only facilitate in the collection and payment of VAT to the government.
- Net VAT payable = Output VAT (due to be paid on sales@5%) – Input VAT (already paid on purchases)
- In cases where the outcome of this formula is negative, then such net VAT is refundable from the government or can be carried forward in the next VAT return.

## Industrial sector in Kuwait

### Industry Overview

The industrial sector in Kuwait is quite small and has contributed approximately 60.6 % of GDP in recent years. It is dominated by oil, derivatives and gas

extraction, production and refining, which will either be exempt or zero rated as per the Unified Agreement. As part of a diversification strategy, non-oil sectors are being promoted in Kuwait.

### Specific Considerations

**Indirect Imports:** Industrials may find themselves in an indirect import situation, where goods are imported to one member state (first point of entry), then transferred to them to the final destination member state. The complication arises since the custom VAT paid in the first member state is not deductible. A statement from the Unified Agreement mitigates the issue. There will be a mechanism to transfer this tax to the final destination state. The importer has to apply for a refund or for a deduction in his own country.

**Utilities – special case:** There are special rules concerning certain utilities, specifically the supply of gas, oil, water, and electricity. As per the Unified Agreement, the place of the supply of these utilities to a taxable trader in another member state is the country of the taxable trader. Otherwise, in case where the client is not a taxable trader, the place of supply is the place of actual consumption. Furthermore, as per UAE regulations, the supply of crude oil and natural gas is zero-rated.

**Cross border transactions:** Industrial should be careful about the place of supply rules associated with VAT, since they are highly likely to purchase and sell across borders. Generally, import of goods attracts custom VAT, and exports of goods and services incur zero-rate treatment. Import of service applies reverse-charge. In case of intra-GCC supply of goods, reverse charge mechanism theoretically applies in the state of arrival. However, due to KSA and UAE regulations the import VAT will continue to be paid at the customs desk for several years.

**Internal transfer of goods without transfer of ownership:** Industrial will often deal with transferred goods, and the transfer is non-taxable—subject to certain conditions. The goods should be temporarily transferred, or the transfer should be part of another taxable supply. For example, it could be the transfer of machinery / equipment for repair, for completion of projects, or conducting tests related to a project.

**Toll Manufacturing:** In a toll manufacturing arrangement, a company provides raw materials / semi-finished goods to a toll manufacturing service provider. The service provider provides manufacturing processes for a fee. Because this is classified as a service, VAT rules concerning the import, export, and internal supply of service must be applied. In case of cross border toll manufacturing transactions, the value of the goods is not taxable. Neither the transfer of the raw material nor the transfer of the finished goods are subject to VAT. Therefore, at the customs desk the VAT must be paid on the value of the service only.

#### General Considerations

**VAT grouping:** It is an option wherein related businesses could register as one single taxable Person under VAT depending on individual business structure and environment. The main purposes of a VAT group is to disregard the intercompany operations on a VAT standpoint and to increase the deduction right of companies carrying out fully or partially exempt activities. Great attention must be paid to the organization of the group and to the internal implementation of the tax group processes to benefit safely of the effectiveness of a VAT group.

**Human resources:** It is a common practice to provide various facilities to employees in lieu of salaries, such as accommodation, gifts, perks etc. The levy of VAT on such facilities is the subject of concern for employers.

**Contracts:** Each business should consider revisiting their existing contracts to update or include the VAT related clauses.

## WHY YOU NEED TO START PREPARING FOR VAT TODAY

A full-fledged, effective, robust and comprehensive VAT implementation takes ample time from planning to execution. Early preparation is recommended as a short time span to implement VAT may result in an enormous burden on the company and its resources.

## Our service offerings

### VAT IMPLEMENTATION

- VAT Awareness
- Assess Impact on Business
- Gap Assessment of IT systems
- VAT Implementation
- Ongoing Compliance Services
- Technical Consulting

### Post implementation VAT subscription

In the frame of this subscription, we provide our clients with constantly available technical support in the frame of a pre-established budgetary framework.

### Flash VAT audits

Post implementation, we also perform flash VAT audits on various specific items.

### VAT Audit trail and VAT internal manual

The documentation of the VAT audit trail is the most reliable methodology to ensure VAT compliance to avoid systemic risks in case of VAT audit

### Customized training

We build specific VAT trainings focused on the activity of the company and on the day to day concerns of the internal VAT stakeholders.

### Tax/VAT archiving processes

The tax/VAT archiving processes will become key for the tax/VAT safety of the companies.

### Contact

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